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Business and Economic Conditions

New York, February 1960

General Business Conditions

THE settlement of the steel dispute early in January removed the principal uncertainty in the near-term outlook, assuring that industrial production and the necessary restocking of steel and steel products can go forward without interruption. With steel mills and automobile assembly plants operating at new peaks for January, there is little doubt that over-all industrial output and payrolls set all-time records during the month. The decline in the stock market has inspired some caution, which at this stage can do no harm because it only moderates what threatened to become excessive optimism. In fact, it would be hard to find fault with the industrial and trade prospect for at least the next few months, for the production needed to fill the void left by the strike will keep purchasing power and activity high.

In President Eisenhower's annual reports to the Congress, January has brought forth the usual official economic forecast, with which there is widespread agreement. The President in his State of the Union message confidently asserted that "1960 promises to be the most prosperous year in our history." The dimensions of this expected prosperity are typified by the figures used as a basis for the federal budget revenue estimates. The assumptions are that the gross national product will total $510 billion in 1960, a growth of 6½ per cent over the $478.8 billion reported for 1959. In the fourth quarter of 1959, with steel shortages hampering output, the rate was $482 billion. Personal income in 1960 is figured to expand 6 per cent, from $380 billion to $402 billion, while corporate profits before taxes are estimated at a new high of $51 billion in 1960.

President Eisenhower has termed these estimates "conservative," and most business observers agree that such levels should be attainable without undue strain on the nation's resources of manpower and industrial capacity. Moreover, the President has taken constructive action to help realize this prosperity. His program to overbalance the budget next fiscal year, achieving a $4.2 billion surplus for debt retirement, has combined with regular seasonal influences to ease the strain on the money and capital markets and tends to quiet fears that shortage of loan funds might suffocate expansion in business and consumer spending.

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"Shared Responsibility" for Growth

President Eisenhower in his Economic Report expressed confidence that "with appropriate private actions and public policies" the economic advance "can carry well beyond the present year." He warned that "we must avoid speculative excesses and actions that would compress gains into so short a period that the rate of growth could not be sustained." The President called on business management, labor leaders, consumers, and government to cooperate through "our free society's system of shared responsibil-

ity" in exercising the self-discipline needed to foster economic growth and improvement.

The degree of success in avoiding excesses will be the key to the durability of current prosperity, as it has been in past business upturns. The President's warning is particularly pertinent in the present situation because the rebuilding of inventories is expected to be a major force in the 1960 business expansion, and this necessarily involves pushing production rates above current consumption levels. How wide the gap is opened and how long it persists will largely determine the size of adjustment which occurs when inventory demands have been met and production once again falls back in line with consumption. Cautious and conservative inventory policies can prolong the business upswing.

In nearly all major industries, business inventories are low in relation to current sales levels by historical standards. Stocks of manufacturers, wholesalers, and retailers when last reported (as of November 30) were still $3 billion below their 1957 peak, while aggregate business sales moved up 6 per cent in the same period. With sales likely to rise further, the need for rebuilding stocks is clear, even if allowance is made for the steady progress made by business management in inventory control and increasing turnover. But whether accumulation is crammed into the first part of 1960 or cautiously stretched out over a longer period can spell the difference between boom and bust or a sustainable expansion.

An abnormal feature of these earliest months of 1960 is need for correcting acute inventory deficiencies in particular lines affected by the steel shutdown. In the automobile industry, for example, nearly 700,000 passenger cars were assembled during January as plants worked overtime to fill back orders and build dealer stocks to more normal levels. About one third of the January production appears to have gone to rebuild dealer stocks. These production rates are excessive even if hopes for a 6½ to 7 million car year are realized. Obviously, cutbacks of schedules lie ahead.

Similarly, steel mills operated during most of January at 95.7 per cent of capacity – 2,727,000 tons a week, equivalent to more than 142 million tons per year. Roger M. Blough, chairman of U.S. Steel Corporation, estimates that as much as 20 per cent of steel shipments will be put into inventories in the first quarter. Even if the year's production should, as rather widely expected, surpass the old record of 117 million tons in 1955, easing of production schedules is to be expected as the year wears on.

Industrial activity has already received nearly all the stimulus it will get this year from automobile and steel production. On the other hand, the expectation is that activity in other industries, such as machinery and other producers' durable goods, will be rising. Export demands have improved, reflecting booming business and lifting of import quotas in Europe and Japan.

Terms of the New Steel Contract

When the steel settlement was achieved on January 4, attention focused on the eventual increase in employment costs, put at 39 to 41 cents per hour. Closer examination shows that the terms of the new 30-month contract are not so inflationary as at first appeared, and the actual cost to the companies between now and the final quarter of 1961 will be well below the maximum figure.

Steelworkers are getting no immediate wage increase, although their take-home pay will rise 6½-7 cents an hour as the companies take over insurance payments formerly borne by employees. On December 1, workers will get a basic wage boost of 7 cents an hour plus a 0.2 cent increase in the spread between each of the 31 wage classifications. This is estimated to increase average hourly earnings by 9.4 cents, while employment costs, which also include the indirect effects on incentive pay, fringe benefits, and payroll taxes, are expected to be 11 cents an hour higher. A similar raise on October 1, 1961, but adding only 0.1 cent to the spread between job classes, will increase earnings an estimated 8.6 cents an hour and employment costs 10.5 cents. A greatly modified cost-of-living escalator clause is included, but workers can receive no more than 3 cents per hour increase under this clause each year and the amount may be reduced by any rise in the companies' insurance costs.

The U.S. Department of Labor calculates the workers' actual gains in wages and fringes at 32.8 cents per hour. Improved insurance, sickness and accident, and pension benefits were included in the new contract. Most notable was a provision for a lump-sum payment of 13 weeks' pay upon retirement, expected to average about $1,500, of which David McDonald, president of the United Steelworkers, said: ". . . this payment, which is in the bank for every steel worker, alone substantially makes up for all the wages lost during our long struggle, without considering all of the other economic improvements." The cost of this and other pension improvements to the industry, however, is estimated at only 3-3½ cents an hour. Altogether, allowing for indirect costs, the industry estimates that the average increase in total employment costs will be 3½

to 3¾ per cent a year during the life of the contract.

An Inflationary Settlement?

Despite some disappointment at the terms, the steel settlement on the whole was welcome news in the business community, which recognized that the dispute had to be reconciled and feared a settlement by political decree, possibly leading the way to government regulation of wage and price levels. The role of Vice President Nixon and Labor Secretary Mitchell, in bringing the two contending parties together, was criticized by some who asserted that the Administration had imposed an inflationary settlement. Whether the settlement was "voluntary" or not is a question perhaps resting on fine shades of meaning. In any case, legal compulsion such as forced arbitration was avoided and no new laws enhancing governmental regulatory powers were passed, as might have happened.

The chairman of the United States Steel Corporation, Roger M. Blough, described the settlement as forced "by circumstances." These circumstances included indications that the union membership, in the ballot provided for by the Taft-Hartley Act, would reject the companies' offer by a solid margin and that renewal of the strike, by inflicting a creeping paralysis upon industry, would lead speedily to compulsory settlement and probably hasty new labor relations legislation. While steel prices are not being advanced for the time being, it was widely predicted that advances would have to be forthcoming, sooner or later, to cover the increase in costs.

The settlement, achieved during the prescribed "cooling off" period, showed the Taft-Hartley machinery working to good effect. Beyond this, the strike was a contest of irreconcilable determination, with the union, if anyone, emerging as the stronger force. But the victory, if it was a victory, was achieved at a heavy cost. The magazine *Steel* put the strike loss in steelworker wages at nearly $1.2 billion. The union, which had a nationally advertised goal of "one billion dollars," succeeded in adding more than this to prospective costs of steel companies over the 30-month contract. But increased take-home pay of steel employees can scarcely reach a half billion. In other words, workers will not gain back over the 30 months of the contract what they lost during four months of strike. The companies lost hundreds of millions in profits as did the Internal Revenue Service in tax collections. Other losses spanned out across the nation in terms of secondary unemployment created by the steel shutdown, added relief burdens for local communities, and lost business for merchants.

There is yet another sort of loss that remains for future shrinkage of the dollar to measure — the effect of the steel settlement on wage negotiations in other industries and in prolonging a general round of further employment cost increases. The added dollar a steelworker gets a couple of years hence may not buy as much as the 1959 dollar he failed to earn because of the strike.

Toward avoiding such costly shutdowns in the future, President Eisenhower, relying primarily upon the good common sense of responsible individuals, has stated his intention "to encourage regular discussions between management and labor outside the bargaining table." Surely free collective bargaining should be preserved. But the still unanswered question is how it can be reconciled with a stable dollar. The record for 25 years is one of employees getting excessive wage increases and of employers passing the cost on to their customers.

A Balanced Appraisal

A balanced appraisal of the new steel agreement was provided by Mr. Blough in a nationally televised program. Mr. Blough implied that the new agreement represented a continuation of "the inflationary wage-price spiral that has been sweeping this country for the past twenty years, and that has cut the purchasing power of the dollar by more than half during that time."

At the same time, the steel executive pointed out that hourly employment costs in the steel industry, which have been rising at a rate of 8 per cent a year for the past twenty years, will increase under the new agreement about 3½ to 3¾ per cent a year. Cutting the rate of wage-cost inflation by half is no negligible achievement.

The achievement looms larger when employment costs are figured against gains in productivity. Shipments per man-hour, Mr. Blough stated, have been rising at an average rate of 2 per cent a year since 1940: "So instead of going up four times as fast as shipments per man-hour, [employment costs per man-hour] will be going up a little less than twice as fast."

By some appraisals the test of whether or not the settlement is "inflationary" rests on steel prices, which have risen at an average rate of 5½ per cent a year. It is strange in a way that so much importance should have become attached to steel prices; food and other prices change from day to day and week to week with greater consequences to the cost of living. The attention given to steel prices reflects the facts that wage-price inflation has been especially persistent in steel and that the industry, with strong support

from people concerned about inflationary trends and dangers, made an all-out effort in the recent negotiations to arrest the process and hold the line on prices.

The industry has announced no price increases, though certainly it should not be subject to unreasoned attack if adjustments in course of time should become necessary. Certainly it would be better to have steel prices marked up than to have the steel industry fall victim to a profits squeeze which would deny the industry opportunity to obtain funds for continuing capital investments in labor-saving plant and equipment and sustain a paramount position in world steel production. Considerations of national defense, if nothing else, dictate need for a strong steel industry. However little anyone wants higher prices, the fact must be recognized that any progressive industry must recover its costs including costs of capital outlays.

The best outcome would be a situation in which price stability is approached by better productivity. The national interest will be served in the degree to which it is possible to finance the new contract by greater effort of the man on the job and union willingness to abandon work rules which waste time and put the companies to unnecessary expense. In other words, the interpretation of the settlement as inflationary can prove mistaken, for opportunity still exists, given strong individual worker and union support, to turn the agreement into a noninflationary settlement with costs offset by increased man-hour effort. Barring this, however, disappointment will remain that hopes of checking the wage-price spiral, which ran so high last summer when a major industry at last took a strong stand, were not realized.

A $4 Billion Budget Surplus

Inflationary psychology received a major setback in January when President Eisenhower proposed, in his budget message for the fiscal year ending June 30, 1961, a $4.2 billion surplus of revenues for debt retirement. He also confirmed that the plan for a balanced budget in current fiscal '60 is working out.

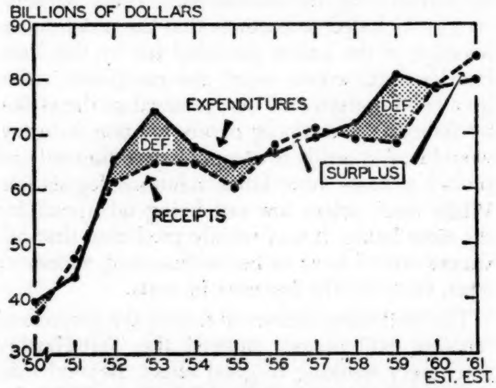
The plan for a balanced fiscal '60 budget had been received with considerable doubt, when submitted a year ago. In the background was the peacetime record deficit shaping up for fiscal '59. Pressures for still more spending created the first difficulty. Then, the prolonged steel strike arose to threaten the prospect for record-high corporate and individual income tax receipts. Spending indeed is up: the $78.4 billion now figured for fiscal '60 is $1.4 billion above the President's original proposal. But though the steel strike took at least $750 million away from the revenues, the tax intake is running better than the President expected a year ago, preserving a narrow $200 million margin of prospective surplus.

Federal Government Expenditures, Receipts, and Public Debt

(In Billions of Dollars)

		Fiscal '60			Fiscal '61
	Fiscal '59 Actual	Jan. '59 Est.	Sept. '59 Est.	Jan. '60 Est.	Jan. '60 Est.
Expenditures	$80.7	$77.0	$78.9	$78.4	$79.8
Receipts	68.3	77.1	79.0	78.6	84.0
Surplus (+) or Def. (—)	—12.4	+0.1	+0.1	+0.2	+4.2
Public Debt, June 30	284.7	285.0	284.7	284.5	280.0

Budget expenditures, at $79.8 billion in fiscal '61, would be up $1.4 billion from current fiscal '60 but $900 million below the peacetime record of $80.7 billion in fiscal '59. At $84 billion, receipts would be the largest this or any other country has ever collected in a single year and, as the chart indicates, more than $23 billion higher than was collected as recently as 1955.



U.S. Government Budget Expenditures, Receipts, and Surplus or Deficit, Fiscal Years Ended June 30, 1950-61

The Treasury is counting on record profits and incomes to bolster receipts. In addition, the $84 billion receipts estimate assumes extension of the 52 per cent corporate tax rate and certain excise tax rates for another year beyond the scheduled expiration date of June 30, 1960.

The debt retirement proposal was a welcome surprise to the money and capital markets which had been laboring under acute tensions as a result of Treasury competition for funds needed for financing business expansion and home-building activity. Bond prices symptomatically advanced on the news while short-term open market money rates dropped. Need for a further rise in the Federal Reserve discount rate was avoided, at least for the time being. Hopes were revived that the ground might be laid for some long overdue tax reforms to re-energize private

enterprise. Now it is up to the Congress to make good by helping to hold expenditures at or below the projected $79.8 billion level.

Some Congressmen indicated doubts that expenditures can be held to the projected level. They pointed out that the planned expenditure figure for fiscal '61 counts on a raise in postal rates to eliminate the prospective $554 million post office deficit, an action Congress refused to take last year. Pay increases for government employees are being pressed, not to mention new projects beyond possibility of enumeration.

Meeting Defense Needs

The President gave assurance that his budget proposals provide all the money needed for "a level of military strength which, together with that of our allies, is sufficient to deter wars, large or small." Major national security outlays are projected at $45.6 billion in fiscal '61, the slight reductions from fiscal '59 and '60 mainly reflecting lower expenditures for military assistance to foreign nations and for stockpiling strategic materials. While the total of national security outlays has remained relatively stable in recent years, around $45 billion, the allocation is shifting to the newest and most powerful weapons.

As the President pointed out, "strategy and tactics of the U.S. military forces are now undergoing one of the greatest transitions in history." This is illustrated by the gradual replacement of airplanes with missiles. The fiscal '61 budget reduces new spending authority for aircraft procurement by $1.4 billion to $4.8 billion while simultaneously increasing authority for missile procurement by $581 million to $3.8 billion. The enormous total of $8.4 billion is proposed for research and development, with $3.9 billion in the Defense Department alone.

Outlays for International Affairs and Finance are figured at $2.2 billion in fiscal '61, back to a more normal level after being inflated in fiscal '59 by a nonrecurring $1.4 billion additional U.S. subscription to the International Monetary Fund.

Federal Budget Expenditures by Major Programs
Fiscal Year 1961
(In Millions of Dollars)

	Fiscal '61 Current Est.	Change From— Fiscal '60 Estimated	Fiscal '59 Actual
Commerce & Housing	$ 2,709	— 293	— 712
Agriculture & Agr. Resources	5,623	+ 510	— 906
Natural Resources	1,938	+ 153	+ 269
Labor & Welfare	4,569	+ 128	+ 148
Veterans Services & Benefits	5,471	+ 314	+ 297
General Government	1,911	+ 200	+ 305
Interest	9,585	+ 200	+1,914
Allowance for Contingencies	200	+ 125	+ 200
Nondefense subtotal	32,006	+1,339	+1,515
National Security	45,568	— 82	— 858
Internat'l. Affairs & Finance	2,242	+ 176	—1,538
Total	$79,816	+1,433	— 881

The President noted that, in helping to improve economic conditions abroad, "we are being joined in larger measure by our friends in the free world who have now reached a high level of prosperity after recovering from the ravages of war." He added that the United States is also trying to encourage more reliance on private enterprise in foreign economic development.

Nondefense Programs

Outlays on nondefense programs have been increased and expenditures for Labor and Welfare, Natural Resources, General Government, and Interest are expected to touch new peaks. Total nondefense outlays are expected to reach $32.0 billion in fiscal '61, $1.3 billion above fiscal '60. The President explained that the great bulk of the increase reflects "relatively uncontrollable expenditures for farm price supports fixed by law, interest on the public debt, veterans compensation and pensions, and public assistance grants," and the fulfillment of "commitments made in prior years for federal housing programs, for civil public works projects and other construction . . ."

The new peak of $4.6 billion in budget spending for Labor and Welfare, more than double the fiscal '51 spending level, reflects increases in a wide variety of health, education, public assistance and labor programs, with about three fourths taking the form of grants to States and localities.

Outlays for Natural Resources are being increased to $1.9 billion, up $153 million from fiscal '60 and $833 million or 75 per cent above their 1956 level. Still higher spending lies ahead, since the budget would authorize starts on 42 new public works projects, after several years in which the President opposed new starts.

Outlays on Veterans Services and Benefits are slated to rise $314 million to $5.5 billion in fiscal '61. This increase reflects the 1959 action by Congress liberalizing non-service-connected pensions, a move which the President estimated could cost $9 billion over the next 40 years.

The Cost of the Debt

Interest payments on the federal debt, currently $292 billion, are expected to total $9.6 billion in fiscal '61, a new high and about 12 per cent of total budget expenditures. The $1.9 billion increase from fiscal '59 is unprecedented but so also are the size of the debt and the rise in market rates of interest in response to fears of inflation, the high level of private demands for money, and the heavy federal borrowing required by the '58 and '59 budget deficits. Although the Treasury now does not need to do

any deficit financing, it feels the higher rates in refunding maturing securities.

It is natural for people to be concerned about the mounting burden of interest cost on the debt. Regrettably, however, efforts in the Congress to hold down interest costs by refusing to raise the 4¼ per cent legal ceiling on new Treasury bonds due in more than five years have been having the opposite effect. The Treasury has been forced to do all its borrowing on securities due within five years, on which there is no rate limit. Resultant congestion in this area of the market has pushed short-term rates above long-term borrowing costs. In January, at a time when some high-grade long-term corporate bonds were being successfully marketed to yield less than 5 per cent, the Treasury had to incur a money cost of 5.36 per cent to sell one-year Treasury bills.

We have missed the boat too often in the past on opportunities to put out long-term bonds. Interest costs today would be lower if we had picked up more long-term money when it was available at lower rates. Now the most vital thing, as the President proposes, is to gain access to all areas of the market and meanwhile put debt retirement on the program.

The Persistent Agricultural Problem

Spending for Agriculture and Agricultural Resources, projected at $5.6 billion in fiscal '61, is second in size only to Interest among nondefense outlays. The need for overhauling federal farm programs has been recognized for years but, in spite of genuine efforts for improvement, it is rather generally agreed that we are nowhere near a solution. As the President pointed out in renewing his demand for new farm legislation, the basic problem is the "unrealistic" high price supports which have stimulated farm production far beyond what people are willing to pay for in the markets. By November 30, 1959 no less than $9.5 billion of farm commodities were in the hands of the Commodity Credit Corporation (CCC), with storage and related costs figured to rise to about $3 million a day.

One result has been that storage of surplus farm commodities has become a sizable business. Senator Stuart Symington, at hearings in January on agricultural problems, commented that: "If I weren't a senator, the first thing I'd do is go into the grain storage business." Mr. Symington showed an advertisement by a manufacturer of storage facilities enticing operators of grain elevators to get aboard "Uncle Sam's gravy train of storing CCC grain."

Nevertheless, Senator Symington made it clear that he wasn't criticizing the operators of commodity storage facilities. They have merely stepped in to meet the market demand for places to put the surplus. Agriculture Secretary Ezra Benson put it well: "I sympathize with those who are now just waking up to the fact that this is a costly, indefensible and unnecessarily wasteful matter. But this is what results from the continuance of an outmoded, unrealistic program." The Secretary added that he has "repeatedly spoken out about this and urged Congress to take action to modify the law so that grain, especially wheat, will flow into markets, not into costly government storage."

The Federal Government's total receipts and expenditures are much bigger than those shown in the regular "administrative" budget covered in the earlier discussion because substantial monies are collected and spent by trust funds such as the old age, unemployment insurance, and highway funds. The over-all aggregates appear in a supplemental statement of the "cash consolidated" budget, which also eliminates transactions between government agencies such as some $1.3 billion interest paid out of the budget into trust funds. The "cash" budget is intended to measure the total flow of cash into and out of the Treasury. Helped by further increase in social security taxes, the receipts side is heralding the new decade of the 1960's by moving up past the $100 billion mark.

Some Plain Talk

When one bears in mind the fact that federal expenditures doubled during the decade of the Fifties, it would seem a modest objective to level off, particularly since international tensions are less acute, employment opportunities are plentiful, and tax reform is a pressing fiscal need. Yet leveling off is not going to be easy. Budget Director Maurice H. Stans did not mince words in stating the problem to the Tax Foundation last December:

> If you are troubled by an $80-billion budget, I can tell you that unless we hold the line now the day is not too distant when the budget will rise to the $90 or 100-billion range.

Mr. Stans sketched in crisp summary some of the factors pushing federal spending up:

> We spend great sums on interest charges on our national debt, but we do not reduce the principal.
>
> We carry on massive federal programs which State and local governments could do better.
>
> We devote large amounts of money to farm price supports to reduce surpluses, with the opposite results.
>
> We lend money to benefit special groups at rates below those which the government must pay to its own creditors, when private sources could do the job.
>
> We perpetuate federal programs which have long since met the objectives for which they were created.

He went on to point out that:

. . . the Federal Government is piling up CODs for the future at an astounding pace.

Even if the next session of the Congress doesn't add any new programs, the level of federal spending is going to go up. The reason is that there are built-in increases in existing programs . . .

. . . the $290 billions of current public debt, plus $350 billion of [unfunded] future obligations for past services [of veterans and civilian government employees], plus $98 billion of CODs, adds to the almost incredible total of $750 billion. That . . . is the Federal Government's mortgage on America's future, beyond the regular annual costs of defense, welfare, and commerce.

. . . the pressures for new spending programs are increasing in intensity.

In the absence of a genuine thaw in the cold war which could lead to a major reduction in military costs, the only way to cut back the level of the budget is to look to the Congress to modify laws that are already on the books.

Meeting Essential Needs

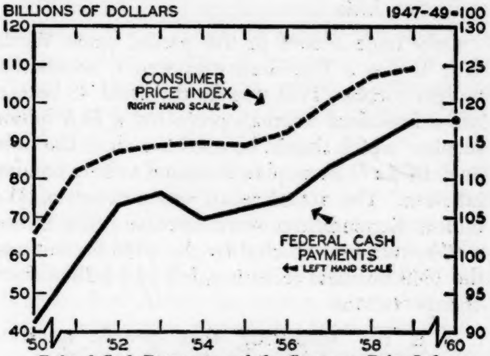
Nevertheless, many people are less impressed by the fiscal burdens of the Federal Government than by needs for still bigger spending programs. Perhaps the most ambitious program is that laid out by the Conference on Economic Progress (CEP), headed by Leon Keyserling, chairman of the Council of Economic Advisers under President Truman.

Criticizing President Eisenhower's budget plans as "creeping negativism," the CEP calls for sharply increasing budget spending. It proposes an $89.5 billion budget for calendar '61, almost $10 billion more than the total planned by the President for fiscal '61. By 1964, the CEP would push federal budget spending up to $102.4 billion.

The CEP asserts that its program would not only prevent "neglect of insistent human needs" but also be more effective in stimulating economic growth and tax revenues. It argues that this approach "by 1964 or earlier would produce a balanced budget." Significantly, however, it adds that if a balanced budget is not achieved "we should not worry about some deficits in the Federal Budget."

The trouble with this approach is that it has never worked. It is easy to squander printing press money and launch a new wave of inflation. But we should have had enough experience over the past 30 years to know what the sequels will be: attacks upon business for excessive profits; demands for controls on wages, prices, and credit; and needs for still higher taxes — themselves acting to increase prices — to try to restore a balance in the budget and in the economy.

It should give pause to advocates of more federal spending that, as the chart shows, the cost of living and federal cash expenditures have shown a clear tendency to move together over the past decade*.



Federal Cash Payments and the Consumer Price Index Calendar Years, 1950-60

It is hard to escape the conclusion that the drastic increases in federal spending proposed by the CEP would push up consumer prices further and victimize pensioners and others on fixed incomes still more cruelly. Not many retired teachers and clergymen would agree with Mr. Keyserling's statement before a House Government Operations Subcommittee last March: "Well, I think that the biggest hooey that has ever been talked about in economics has been this crusade on behalf of the people on fixed incomes . . ."

Can a Surplus Survive?

In recommending a sizable surplus for fiscal '61, the President noted that we have made "encouraging progress" and stressed that "in times of prosperity, such as we anticipate in the coming year, sound fiscal and economic policy requires a budget surplus to help counteract inflationary pressures, to ease conditions in capital and credit markets, and to increase the supply of savings available for the productive investment so essential to continued economic growth."

Systematic redemption in good times of debt incurred in war and recession periods has been too long ignored. It was last applied during the prosperous Twenties. With the help of budgetary provisions for sinking funds and underestimation of revenues, one third of the debt incurred in World War I was repaid. In the checkered history of fiscal policy over the past 30 years, we have never realized a planned surplus of any real size.

The one big surplus over this period, $8.4 billion in fiscal '48, was fortuitous. Revenues

*For further discussion of the relationship between federal cash spending and the cost of living, see the article on "A Budget Out of Control" in the October 1958 issue of this *Letter*.

were grossly underestimated. The 80th Congress, intent on reducing taxes, resisted spending proposals. President Truman vetoed successive tax reduction bills.

Only once before in the period since World War II has a President proposed a substantial budget surplus. That was for the fiscal '49 budget when President Truman projected a $4.8 billion surplus "which should be used to reduce the public debt" as "a fiscal plan designed to help combat inflation." The actual result was a deficit of $1.8 billion. Expenditures were increased $2.3 billion while revenues, affected by the 1948 tax cut and the 1949 business recession, fell $4.3 billion short of expectations.

It is not surprising that people question whether a $4.2 billion surplus has any chance of survival. From every side there are demands for more spending and easier taxes. To carry out the plan seems a test of national fortitude. Rather it is a test of ability to see the benefits.

There is concern over the weight of interest on the public debt. The only honest way to moderate these charges is by debt retirement.

There is concern over financing difficulties for business, homebuilders, states, and municipalities. The best way to relieve pressures in the money and capital markets is to pay off federal debt and put money in the hands of lenders for reinvestment.

There is concern over the effects of our excessive income tax rates on initiative, on private capital accumulation, on American competitive power in world markets, on economic growth. The only sensible way to solve these problems is to build surpluses which can give leeway to reduce tax-drags on progress.

There is concern over the balance of payments deficit and gold outflow. The essential way to reassure nations abroad that we intend to keep the dollar the central tower of strength among world currencies is to take the advice we have so long been giving friendly nations abroad – to pursue sound fiscal policy.

We have all these reasons to build surplus revenues. The task now is to carry out the plan.

The Scarcity of Money

Many complaints are heard over scarcity of money. Some say it has caused a "low rate of economic growth" and "excessive unemployment." Higher interest rates certainly reveal a scarcity of money relative to the desires of individuals, business firms, and governments to borrow. Some activities, such as home building, are slowed by difficulties in finding money.

On the other hand, people have more money and other liquid resources than ever before; their spending is rising and demands in the markets are sufficient to produce some measurable upward movement in price averages. The evidence from this side is that the supply of money is fully adequate. The most recent bottleneck on production has not been lack of money but rather strikes for higher wages and benefits.

As Dr. Per Jacobsson, managing director of the International Monetary Fund, said in his Stamp Memorial Lecture before the University of London on November 19, the central bank is the ultimate source of money under the modern credit system. In the United States it is the Federal Reserve System which has the responsibility of regulating the supply of cash which lies at the base of the credit structure.

The general idea is that the Federal Reserve makes it easier for people to borrow when business is slow and harder for them to borrow when business is active. When business is slow, and people are cautious in spending, increased availability of money and credit is intended to spur spending and create jobs. When business is active, and jobs abundant, less ready availability of money and credit is intended to check spending and restrain tendencies of prices to rise. The whole objective is to try to maintain a high level of over-all business with reasonable stability in prices and without interfering with the freedoms of people to use their money as they please.

Nevertheless, the shortages of borrowed money, and the rising interest rates, which naturally develop in periods of prosperity, become objects of widespread complaint. Yet if too much money and credit are supplied, central banks invite even greater condemnation – for feeding price inflation and building a top-heavy credit structure which threatens economic collapse. The monetary authorities in any country have a narrow road to travel.

The Federal Reserve's View

Federal Reserve officials see clearly the needs of a growing economy for more money. But they have repeatedly warned that too much money means inflation. Back in 1951, Federal Reserve Board Chairman William McChesney Martin defined the proper amount of money for the Congressional Joint Economic Committee's study of General Credit Control and Debt Management:

> There is enough money when the quantity is sufficient to support the volume of spending necessary to support a high level of production and employment, without lead-

ing to spending at a rate which would outstrip the supply of available goods and services at prevailing prices and result in an inflationary rise in prices. . . . [An] economy which is expanding tends to require a gradually increasing money supply.

Ideally, the amount of money should adjust itself to the periodic waves of pressure for increased or decreased holdings of money on the part of the public. For example, at times businesses and consumers may increase their expenditures by using existing cash balances more intensively (what economists call "increasing outlays relative to cash balances" or "increasing the velocity of circulation of money.") If this happens when productive resources are fully utilized and prices are tending to rise, it is desirable that pressure be exerted to restrain so far as possible further expansion in the amount of money in the economy.

Last June, testifying before the House Ways and Means Committee on the President's request to remove the 4¼ per cent interest rate ceiling on U.S. bonds, Chairman Martin said:

. . . I do want to point out that in 8 years of experience in the Federal Reserve System, I am convinced that our bias, if anything, has been on the side of too much money rather than too little.

Mr. Martin joined the System in 1951. Price inflation has been better contained than previously; nevertheless, the official consumer price index has edged upwards an average of 1.1 per cent a year over this period.

The way the Federal Reserve has operated has been to encourage expansion of the money supply* in periods of business recession and to hold back in periods of prosperity. Thus, the main increases in money supply have occurred in periods of business recession and in the early stages of business recovery. For example, in response to an easy money policy, the money supply as usually calculated was enlarged $5.7 billion or 4 per cent in 1958, while a restrictive policy held the 1959 increase below $1 billion. What has happened is that enough money has been provided in recession years to finance an ensuing boom.

It is still true, as critics so often have argued, that growth in money supply since World War II has not kept up to the increase in gross national product. But this is another story.

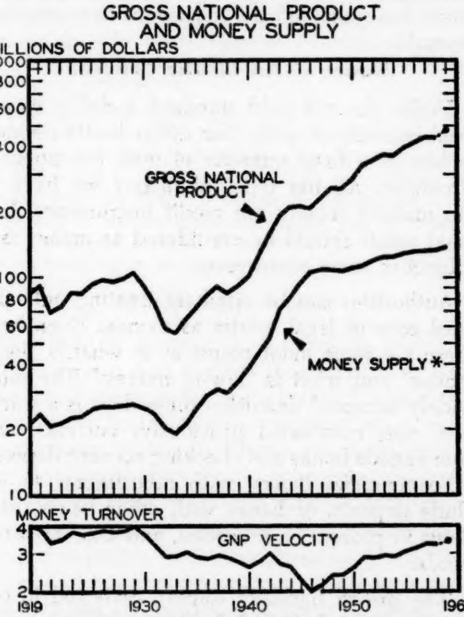
Money Supply and Velocity

The broad question of the influence of the money supply on prices and production was taken up last May in the course of the Congressional Joint Economic Committee's recent study of Employment, Growth, and Price Levels.

*Defined in accordance with a common practice as currency and coin outside banks and checking account deposits at commercial banks, with adjustments to exclude deposits of banks with other banks, cash items in process of collection, and U.S. Treasury funds.

As was pointed out at the hearings, money supply has generally increased over long spans of history, falling only during periods of depression and sharp credit contraction. As a broad tendency, it has grown at around the same rate as the dollar volume of business. This is illustrated in the first chart which compares the growth in money supply and the gross national product (GNP) since 1919.

Those who argue that money supply is inadequate point to its failure to expand as fast as GNP since 1946. What is often ignored, however, is that money supply was abnormally inflated during the Great Depression and World War II. Since 1946 the excess money has been drawn into active use; dollars have been turning over faster and not only financing more trade but also accommodating wage and price inflation



Money Supply at June Call Dates; GNP for Calendar Years. (Ratio scale to show proportionate changes.)

*Currency and coin outside banks and checking account deposits at commercial banks, with adjustments to exclude deposits of banks with other banks, cash items in process of collection, and U.S. Treasury funds.

The rise in the rate of the use of money since 1946 can be seen in the bottom block of the chart which shows the ratio of GNP to the money supply. This is the so-called GNP velocity of money — the calculated number of dollars of GNP we get in a year out of a dollar of money supply. As the chart shows, we got only $2 of GNP per $1 of money supply in 1946 but the ratio has since risen more than 50 per cent to about 3¼. It has moved ahead of the 3 level that prevailed during the Great Depression but

is still short of the decade of the Twenties when ratios as high as 4 were recorded.

We have been learning how to get more mileage out of our money balances. Corporation treasurers, for example, have worked to achieve better coordination of payments and receipts. The availability of an increasing volume of money market instruments — Treasury bills, finance company paper, etc. — has provided enlarged means for investment of temporarily idle funds. The GNP velocity of money, trending strongly upwards, shows some hesitation only in recession years like 1949, 1954, and 1958, when corporate cash tended to accumulate out of inventory liquidation and declining money rates discouraged investment of idle funds.

At the same time, the growth of nonbank financial institutions and increasing use of personal credit have enabled the individual to economize on cash.

Money — An Elastic Concept

Under the old gold standard a dollar was a fixed quantity of gold. The dollar is still defined in law as a fixed quantity of gold but no gold circulates. All the types of money we have in the modern society are credit instruments. Just what assets should be considered as money is a subject of some controversy.

Authorities can be cited for treating only the hard core of legal tender as money. Even here there are some moot points as to what is "legal tender" and what is "lawful money." The most widely accepted definition these days is a statistical one, mentioned previously: currency and coin outside banks and checking account deposits at commercial banks, with adjustments to exclude deposits of banks with other banks, cash items in process of collection, and U.S. Treasury funds.

The British Radcliffe Report, reviewed in our October issue, belittled the importance of money supply and placed the emphasis instead upon a broader concept of over-all "liquidity": "Spending is not limited by the amount of money in existence; but it is related to the amount of money people think they can get hold of, whether by receipts of incomes . . . , by disposal of capital assets or by borrowing."

In the United States, under the influence of John Gurley and Edward Shaw of the Brookings Institution, monetary theory in recent years has been probing toward broader comprehension. Dr. Gurley told the Congressional Joint Economic Committee that credit supplied by the rapid growth of nonbank financial institutions and the liquidity they provide in the form of savings deposits, savings and loan shares, etc., must be taken into account in measuring the adequacy of the money supply:

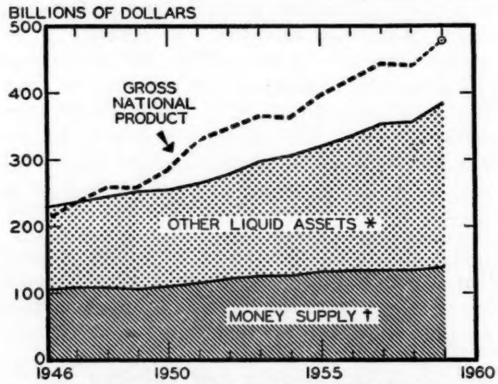
> Why have monetary policies failed to halt the price increases? The basic reason is that these policies have failed to slow down sufficiently the growth of aggregate demand for current output of goods and services. They have failed to do this, I believe, largely because the monetary system's supply of loanable funds has not been limited nearly enough in view of the very large supply of these funds coming from other sources, principally from nonmonetary intermediaries.

Growth of Other Liquid Assets

Any review of the alleged inadequacy of the growth in money supply as conventionally defined must take into account the fact that the supply of other liquid assets has been rising too, and more rapidly than money supply. In other words, people have been inclined to put more of their money into interest-bearing forms.

Since World War II many people have cashed in Savings bonds, which represent a kind of money in that the holder has rights of ready redemption. Other types of interest-bearing liquid assets have grown rapidly. For example, savings lodged with commercial banks, mutual savings banks, savings and loan associations, and credit unions have grown much faster than money supply. People can and do regard these resources as "money" that they hold.

Other liquid assets which are the practical equivalent of money are marketable U.S. Gov-



Gross National Product, Money Supply, and Other Liquid Assets
Money Supply and Other Liquid Assets at End of June; GNP for Calendar Year.

***Includes savings and time deposits in commercial and mutual savings banks; Postal Savings deposits; savings and loan and credit union shares; U.S. Savings bonds; U. S. marketable debt due within one year held outside banks.**

†Currency and coin outside banks and checking account deposits at commercial banks, with adjustments to exclude deposits of banks with other banks, cash items in process of collection, and U.S. Treasury funds.

Sources: U.S. Treasury Department; U.S. Commerce Department; Federal Reserve Board; Bureau of Federal Credit Unions.

ernment securities maturing within a year. Most noteworthy in this classification are U.S. Treasury bills, reduced in aggregate outstanding amount from $17 billion at the close of World War II to $11.5 billion in 1949 and subsequently increased to a present figure of $41 billion. The bulk is held by corporations, foreign accounts, and a miscellany of nonbank investors.

In the preceding chart "other liquid assets" are superimposed upon money supply as commonly defined. The items added are savings and time deposits (in commercial and mutual savings banks and the postal savings system), savings and loan and credit union shares, U.S. Savings bonds, and marketable U.S. Government securities due within a year. This gives a liquid assets total that has risen at a fairly uniform rate, and, during the 1950's, more nearly as fast as the GNP.

Other Flaws

The money supply as commonly defined is less than half what people may conceive as their ready money. The usefulness of the figure is as a measure of immediate means of payment. Even for this purpose the money supply figures should not be taken too literally. Among other things, the current figures from month to month are estimated rather than exact. They leave out a considerable but unknown amount of U.S. dollar deposits carried with foreign banks. The exclusion of U.S. Treasury funds, fluctuating widely and affecting the money supply as conventionally calculated, is likewise open to objection. No deposits at Federal Reserve Banks are included even though checks drawn on the Reserve Banks have become a sort of "third currency," used not only by member banks and the U.S. Treasury but also by security dealers, large corporations, foreign accounts and international institutions.

Thus, even though money supply figures are to be regarded as vital economic statistics, they are neither precise for their narrower purpose nor comprehensive for broader consideration of the availability of money and credit. People can construe their money supply more liberally than theoreticians would like them to: a short-term obligation of a reputable borrower can be regarded as the same thing as money in the bank. Likewise, there are many sources of credit other than the commercial banks.

Implications for Policy

The very imprecision and arbitrariness involved in defining money supply point up the problems facing Federal Reserve officials in their efforts to constrain excessive credit expansion when optimism runs high and the tendency is for people to overextend themselves. Central bankers properly have been suspicious of rigid formulas which would say the money supply should increase by some fixed percentage each year. Allan Sproul, in a May 1956 address to the New Jersey Bankers Association, stated the problem from his own experience as President of the Federal Reserve Bank of New York:

> There are those who would discard or discount the evidence of the figures of bank credit if it does not jibe with certain formulae concerning the optimum relationship between the "money supply" and the growth of the economy. They are inclined to believe that the money supply has been lagging during the past year or more in which the Federal Reserve System has been following a policy of credit restraint, and that this may be slowly strangling business.
>
> I must confess that I have little confidence in these mechanical formulae. I think this one, to the extent that it is applicable, is only applicable over long periods of time. It produces pretty effective charts of the past fifty years, but doesn't tell you much about the next fifty days or even weeks.
>
> There are inherent difficulties in defining the "money supply," in measuring it, and in allowing for its changing distribution and for the changing intensity of its use, which rob it of much of its short term validity as a guide to credit policy. It cannot be disregarded as a component of our economic well being, but it is only one factor in the complex of monetary and credit phenomena which must be viewed together.

The Broader View

The lack of a rigorous connection between money supply and economic activity has led some to disparage the usefulness of monetary policy as an instrument for helping attain balanced economic growth. People can elude monetary restraint by spending their incomes faster or, so far as possible, paying high rates to borrow other people's idle balances. But before long reduced liquidity and difficulties of borrowing do act to retard spending and in this way provide an essential brake on inflationary tendencies.

Scarcity of money goes hand in hand with prosperity. As Dr. Jacobsson put it in his lecture, we are entering a period which has been called the "Second Industrial Revolution." It is better thus than to have money go begging in economic depression when people are afraid to invest and put the unemployed to work.

An index, covering all editions of the *Letter* issued in 1959, is now available free of charge. Requests should be sent to our Public Relations Department, 55 Wall Street, New York 15, N. Y.

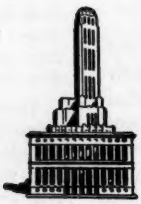
HIGHLIGHTS of 1959

from the Annual Report of

The First National City Bank of New York

and

First National City Trust Company



In 1959:

▶Operating earnings after taxes totaled $67,-961,657 ($5.66 per share on 12,000,000 shares outstanding).

▶Sales of securities resulted in losses of $9,940,-908, which were charged against reserves.

▶Dividends paid at the rate of $3 per share per annum totaled $36,000,000. (At the annual meeting a stock dividend of 2% was approved by the shareholders.)

▶Total staff expense, domestic and foreign, came to $92,702,000.

▶Taxes, here and abroad, totaled $56,673,000.

▶Capital funds at the year-end total $765,109,545 ($63.76 per share) compared with $747,774,-659 ($62.31 per share) a year earlier.

▶Total resources of the Bank increased to $8,123,-000,000, deposits to $7,104,000,000 and loans to $4,416,000,000.

▶Fifteen new banking offices were opened, six in New York and nine overseas, bringing the number to 168, of which 85 are in New York and 83 in 28 countries overseas.

▶Depositors' accounts number 1,260,000, staff 17,858 and shareholders 69,663.

For copy of complete Annual Report, write the Public Relations Department, The First National City Bank of New York, 55 Wall Street, New York 15, New York.

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